

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
	:	
of	:	
	:	
GUISEPPE LOGIUDICE	:	
	:	
For Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period September 1, 1995	:	
through February 28, 1998.	:	
	:	
	:	DETERMINATION
In the Matter of the Petition	:	DTA NOS.
	:	817210 AND 817211
of	:	
	:	
JOSEPH LOGIUDICE D/B/A	:	
NINO'S PIZZERIA OF PATCHOGUE	:	
	:	
For Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1995	:	
through February 28, 1998.	:	
	:	

Petitioner, Guiseppe LoGiudice, 6 Andorra Lane, Lake Grove, New York 11755-2702, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1995 through February 28, 1998.

Petitioner, Joseph LoGiudice d/b/a Nino's Pizzeria of Patchogue, 580 Old Medford Avenue, Patchogue, New York 11772, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1995 through February 28, 1998.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, State Office Building, Veterans Memorial Highway, Hauppauge, New York, on April 26, 2000 at 10:30 A.M., with all briefs to be submitted by August 15, 2000, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). Petitioner appeared by Robert J. Zysk, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

- I. Whether the Division of Taxation correctly determined, upon audit, that petitioner owed additional sales tax with respect to the operation of Nino's Pizzeria of Patchogue.
- II. Whether, if so, petitioner has nonetheless established sufficient basis to warrant reduction or abatement of penalties.

FINDINGS OF FACT

1. In August 1993, the Division of Taxation ("Division") commenced a sales tax field audit of Nino's Pizzeria ("Nino's"), a pizza parlor located in Patchogue, New York and operated as a sole proprietorship by Guiseppe LoGiudice. Guiseppe LoGiudice is also known as Joseph LoGiudice.

2. The Division's audit commenced with the auditor's issuance of an audit appointment letter and request for books and records dated March 13, 1998, stating "[a]ll books and records pertaining to your sales and use tax liability for the period [03/01/95 through 02/28/98] are to be available on the [04/02/98] appointment date. This includes financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, federal income tax returns, and exemption certificates." This letter, which was accompanied by an

attached checklist again specifying the records required for audit, also noted that additional information might be required during the course of the audit.

3. In response to the appointment letter, Mr. LoGiudice telephoned the auditor on March 31, 1998 and directed her to one Robert Smith who served as petitioner's accountant.¹ The auditor telephoned Mr. Smith on April 1, 1998 and scheduled an appointment for May 6, 1998. On May 6, 1998 the auditor went to Mr. Smith's office, located in his home, in order to review petitioner's records. At their meeting, Mr. Smith presented only monthly bank statements for a small part of the audit period, specifically for December 1994 and for January, April, May, and August through December of 1995. No cash receipts journal, sales invoices, sales journal, general ledger, purchase journal, purchase invoices, income tax returns or other records were presented or made available to the auditor.

4. By a letter dated May 29, 1998, the auditor advised petitioner as follows:

As you are aware, a sales tax audit of [Nino's Pizzeria] is currently in progress. Per our discussions, the books and records presented for review are insufficient to determine if the proper amount of sales tax has been reported for the audit period.

This letter will confirm our recent conversation regarding the necessity to perform an observation at your place of business within the next six weeks. Sales activity will be recorded for an entire day, from opening to closing. The observation will be performed discreetly, with minimal interruption of business activity.

If there are any questions, please contact me.

5. On Thursday, June 18, 1998, described as a "hot and sunny" day, an observation of petitioner's sales was conducted by two Division investigators. The observation commenced at 11:00 A.M., with Nino's cash register set at zero. All sales were recorded and tax was included

¹ Robert Smith's accounting credentials (e.g., CPA, PA) are not specified in the record.

in the price of all items sold except for dinners and heroes. Petitioner and his son were present and working at the premises during the observation, and petitioner's accountant was called by petitioner and arrived in the afternoon for a scheduled meeting with petitioner. The observation continued until 10:00 P.M., at which time the cash register was again set at zero and the register tape for the entire observation period was given to the investigator then present. The investigators totaled gross sales for the day at \$828.51, while the register tape totaled gross sales at \$874.15. Taxable sales (versus gross sales) totaled \$807.53.

6. The auditor reviewed reported taxable sales per petitioner's sales tax returns and identified the sales tax quarterly period spanning June 1, 1997 through August 31, 1997 as that with the highest reported taxable sales. The auditor divided reported taxable sales for such quarterly period (\$9,053.00) by the number of days in such quarterly period (92) to arrive at average taxable sales of \$98.40 per day. The auditor reduced the taxable sales total for the observation day (\$807.53) by the average reported taxable sales per day (\$98.40), to arrive at audited unreported taxable sales per day of \$709.13. The auditor then compared such audited unreported taxable sales per day (\$709.13) to average reported taxable sales per day (\$98.40), resulting in an error (underreporting) rate of 720.64 percent. The auditor applied such error rate to petitioner's reported taxable sales for the audit period, and arrived at additional taxable sales of \$724,308.06 with sales tax due thereon in the amount of \$68,606.43. Finally, the auditor allowed credit for the sales tax reported and paid by petitioner for the audit period (\$8,346.00), leaving sales tax due in the amount of \$60,260.00.

7. On October 13, 1998 the Division issued to petitioner, Joseph LoGiudice d/b/a Nino's Pizzeria of Patchogue, a Notice of Determination assessing sales tax due for the period March 1, 1995 through February 28, 1998 in the amount of \$60,260.00, plus interest and penalties

including omnibus penalty. On November 5, 1998 the Division issued to petitioner, Guiseppe LoGiudice, a Notice of Determination assessing sales tax due for the period September 1, 1995 through February 28, 1998 in the amount of \$50,183.00, plus interest and penalties including omnibus penalty.²

8. Petitioner timely challenged the notices by filing petitions with the Division of Tax Appeals. At hearing, petitioner presented the testimony of Thomas Mellett, a project engineer with the New York State Department of Transportation during the period when Route 112, which runs in front of petitioner's business location, was widened. As a part of this project, a new driveway entrance to the shopping plaza in which petitioner's business is located was constructed and the old driveway was removed. Mr. Mellet was not assigned to this particular project, although he visited the project on approximately five occasions. He was unable to discern from the construction maps for the project the exact manner in which the driveway change occurred, and was unable to state whether or not access to petitioner's place of business was blocked or obstructed in any manner for any period of time. However, the usual manner of proceeding is not to remove an existing driveway before a new one is constructed, and on occasion and if a driveway is of sufficient width, one half may be used for access while the other half is reconstructed. The goal in such projects was to maintain access to business premises and to minimize traffic disruption. The project involving Route 112 spanned the period August 1995

² On May 8, 1998 petitioner executed, under the name Joseph LoGiudice, a Consent Extending the Period of Limitations on Assessment under which the Division could assess tax for the period March 1, 1995 through November 30, 1995 at any time on or before December 20, 1998. It is undisputed that Joseph LoGiudice and Guiseppe LoGiudice are one and the same person, and it is clear that the difference in the dollar amounts of tax assessed on the two notices results from the fact that the October 13, 1998 Notice (issued to Joseph LoGiudice) includes two sales tax quarterly periods not covered by the November 5, 1998 Notice (issued to Guiseppe LoGiudice). It appears that two notices were issued in this case because Mr. LoGiudice uses two names, Joseph and Guiseppe. It also appears that the later-dated Notice did not include the two additional quarterly periods because there was no Consent executed in the name of Guiseppe LoGiudice. In any event, there is no claim by the Division that the amounts assessed are cumulative, and it is undisputed that the amount in issue is \$60,260.00 in tax, plus interest and penalties.

through August 1997. The portion of this period when construction activities occurred in and about the area of petitioner's business location is not specified.

9. As noted above, the only records provided at the time of audit were business checking account bank statements given to the auditor by petitioner's accountant, Mr. Smith, and covering some 9 months out of the 36 months of the audit period. During, and then after the hearing, petitioner submitted additional business checking account bank statements such that statements for each month of the years 1995 (except for February and March), 1996 and 1997 were provided.

10. Petitioner also provided meteorological records for the years 1995 and 1996 listing, among other information, daily snowfall amounts. Review of these records reveals the following:

1995: Snowfalls exceeding two inches were recorded on 2/4/95 (5 inches), 11/29/95 (4 inches) and 12/20/95 (8 inches). On four other dates snowfalls ranging from one to two inches were recorded.

1996: Snowfalls exceeding two inches were recorded on 1/7/96 (7 inches), 1/8/96 (14 inches), 2/3/96 (8.5 inches), 2/14/96 (3 inches), 2/16/96 (4 inches), 2/17/96 (4 inches), 3/2/96 (6 inches), 3/18/96 (4 inches), 3/29/96 (2.5 inches), 4/8/96 (3 inches) and 4/10/96 (12 inches). On five other dates snowfalls ranging from one to two inches were recorded.

11. At hearing, petitioner submitted invoices from Dore Foods, Inc., showing purchases by Nino's for the years 1995, 1996, 1997 and 1998, attached to which were adding machine tapes listing the total of such purchases per year. Petitioner also submitted his Federal income tax returns, including Schedule C ("Profit or Loss from Business") pertaining to Nino's, for each of the years 1996, 1997 and 1998. Review of such documents, as well as review of the sales and use tax returns filed by Nino's, provides the following information:

<u>Sales Tax Returns</u>	<u>Purchase Invoices</u>
<u>Gross Sales as Reported/Period</u>	<u>Purchases/Year</u>
\$35,467.00 (12/01/94 - 11/30/95)	\$24,275.00 (1995)
\$35,117.00 (12/01/95 - 11/30/96)	\$22,160.34 (1996)
\$38,663.00 (12/01/96 - 11/30/97)	\$14,807.00 (1997)
\$80,667.00 (12/01/97 - 11/30/98)	\$22,153.35 (1998)

<u>Schedule C Gross Receipts or Sales/Year</u>	<u>Schedule C Cost of Goods Sold/Year</u>
\$71,842.00 (1996)	\$24,902.00 (1996)
\$74,947.00 (1997)	\$26,074.00 (1997)
\$90,238.00 (1998)	\$36,634.00 (1998)

12. Review of the individual sales and use tax returns for the sales tax quarterly periods ended February 28, 1995 through May 31, 1998 reflect reported gross sales ranging from a low of \$8,129.00 to a high of \$10,569.00. For the two immediately following sales tax quarterly periods ended August 31, 1998 and November 30, 1998, reported gross sales nearly tripled to \$29,423.00 and \$29,189.00, respectively.

13. In addition to the foregoing, petitioner also submitted a one-page sheet listing gourmet pizzas. The prices for these pizzas were approximately double the prices listed for the pizzas available on petitioner's regular menu.

SUMMARY OF PETITIONER'S POSITION

14. Petitioner alleges that the audit method employed in this case did not accurately reflect Nino's business for the period in question. In this regard, petitioner objects to the use of an observation and projection audit method, maintaining that it is inappropriate to calculate sales for a three-year period based on a projection of sales made on one day. Petitioner notes that he was not given advance notice of the particular day on which the observation was to occur.

Petitioner further complains that, notwithstanding the admitted absence of original records of sales, there nonetheless existed other records, including purchase invoices and bank statements, upon which another audit method could have been based. In this regard, petitioner asserts that these other records were available at the time of audit, but that the auditor did not request such records. Petitioner further argues that the auditor should not have met with petitioner's accountant, Mr. Smith, because the auditor did not obtain a power of attorney from petitioner authorizing Mr. Smith to be his representative.

15. In addition to challenging the audit method used and asserting that records were available such that a different and better audit method could have been undertaken, petitioner also maintains that the audit did not make any allowance for certain factors affecting petitioner's business during the period under audit. In particular, petitioner claims that the major road widening project on Route 112, which runs in front of the entrance to the shopping plaza where Nino's is located and which involved the relocation of a driveway entrance, severely disrupted petitioner's business. Petitioner further maintains that weather records for the winters of 1995/1996 and 1996/1997 reveal that some 16 major snowstorms occurred on Long Island and that his business was negatively impacted as a result. Finally, petitioner claimed that the one-page sheet listing gourmet pizzas was first placed on the counter at Nino's Pizzeria on the day of the observation. He posits in turn that sales of these more expensive gourmet pizzas on the day of observation skewed the results of the observation in comparison to the normal amount of sales made on a given day.

CONCLUSIONS OF LAW

A. It is well established that every person required to collect tax must maintain and make available for audit upon request records sufficient to verify all transactions in a manner suitable

to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). Failure to maintain and make available such records, or the maintenance of inadequate records, will result in the Division's estimating tax due (Tax Law § 1138[a]; *see, Matter of Ristorante Puglia, Ltd. v. Chu*, 102 AD2d 348, 478 NYS2d 91, 93; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451, 452). To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment. The purpose of such an examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109; *Matter of King Crab Rest. v. State Tax Commn.*, 134 AD2d 51, 522 NYS2d 978).

B. Petitioner received an audit appointment letter specifying the sales tax records requested for audit review, together with a check list of such records. In response, the auditor was specifically directed by petitioner to contact petitioner's accountant in order to obtain records. The auditor contacted and met with petitioner's accountant. However, the only records made available to the auditor were business checking account bank statements pertaining to Nino's for 9 out of the 36 months of the audit period. Given the clear, written request for records, and the response thereto by petitioner and his accountant, it was entirely appropriate for the Division's auditor to conclude that petitioner's records were inadequate and insufficient for purposes of conducting a detailed audit of such records to verify taxable sales and sales tax due. In fact, even when the auditor advised petitioner by letter dated May 29, 1998 that his records were insufficient and that an observation of sales would be conducted, there is no claim that petitioner came forward with any additional records, including any records of sales.

Accordingly, the auditor's decision to go forward with an indirect auditing methodology and estimate sales tax due on the basis of external indices is sustained.

C. Where, as here, the Division seeks to determine a taxpayer's sales tax liability on the basis of an indirect audit method, the methodology selected must be reasonably calculated to reflect the taxes due (*Matter of Ristorante Puglia, Ltd. v. Chu, supra*; *Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, 157, *cert denied* 355 US 869, 2 L Ed 2d 75).

However, exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, 177, *aff'd* 44 NY2d 684, 405 NYS2d 454; *Matter of Lefkowitz*, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

D. In this case, the Division conducted an observation of petitioner's sales for an entire day, compared the results thereof to the average reported daily sales as computed via reference to petitioner's sales tax returns, then derived by comparison an error rate and projected the same against petitioner's reported sales to arrive at audited taxable sales.³ Given the fact that no records other than the noted bank statements were made available at the time of audit, the use of an observation test was clearly one of the indirect or estimation audit methods available to the Division (*Matter of Club Marakesh v. State Tax Commn.*, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276; *Matter of Meskouris Bros. v. Chu, supra*). Petitioner

³ Petitioner complains that the auditor determined average reported daily sales from a sales tax quarterly period for which petitioner reported a comparatively higher amount of sales. While petitioner seems to imply that this would work to his disadvantage, the opposite is actually true since comparison of the highest amount of average daily sales to sales on the day of observation results (mathematically) in a lower error percentage than would comparison of a lower amount of average reported daily sales to sales on the day of observation.

argues that the use of such method with a projection based on the result of one day of observation is unacceptable. However, the same has been upheld on many occasions (*Matter of Del's Mini Deli v. Tax Appeals Tribunal*, 205 AD2d 989, 613 NYS2d 967; *Matter of Top Shelf, Inc. t/a Burns Park Deli*, Tax Appeals Tribunal, February 6, 1992).

E. In attacking the observation audit conducted in this case, petitioner claims he was given no advance notice of the particular day on which the observation was to be conducted, asserts that the observation results were not representative of an ordinary day, and maintains that certain unusual circumstances (construction activity, weather events, and a new specialty pizza menu) should have been factored into the audit. Specifically, petitioner claims that the introduction of a gourmet pizza menu, allegedly for the first time on the day of observation, featuring costlier pizzas, may have resulted in far higher sales than on previous days. Whatever the accuracy of the claim regarding the specific date on which such menu was first offered, it remains that petitioner produced no sales records before or after such point in time to support or bear out this claim. Petitioner further maintains, as detailed, that a road widening construction project disrupted his business and adversely impacted sales for periods covered by the audit, as did weather conditions during the winter months. With regard to the former claim, there is no evidence establishing that access to his business premises was ever closed for any period of time. In fact, such an assertion runs directly contrary to the stated aim of minimizing business disruption during construction. As to the latter claim of weather impact, petitioner's reported sales remained relatively consistent throughout most of the audit period. In fact, Nino's reported sales actually increased somewhat during the quarterly period spanning December 1, 1995 through February 28, 1996, which quarterly period showed the highest number of larger snowfalls (*see* Finding of Fact "10"). One would think that petitioner's sales would show some

evidence of fluctuations in light of the claimed disruptions, including marked decreases during the construction period or during the winter months. To the contrary, however, petitioner's sales as reported per sales tax returns remained essentially consistent. In fact, the only marked change occurs in the two sales tax quarterly periods immediately following the Division's issuance of its audit appointment letter, in each of which there is a near tripling of reported sales.

F. In addition, petitioner seems to argue that other audit methods could have been employed. However, the Division is not limited or otherwise required to use a particular indirect audit method but instead is only required, in the face of inadequate, unreliable or unavailable records, to employ a reasonable method. Here, the records submitted were not adequate to perform a detailed audit and verify petitioner's sales and sales tax liability. Noting that petitioner's business is a cash business, the introduction of checking account statements is not dispositive of sales receipts, for there is no proof that all receipts were deposited intact into such account. While those records ultimately furnished might have allowed for the use of indirect or estimation audit methods other than (or in conjunction with) an observation audit method (e.g., purchase markup, bank reconciliation, etc.), it remains that such records were not made available at the time of audit. Moreover, those records provided do not in any manner lead to a conclusion that such records were sufficient for the conduct of a detailed audit, or that the Division was required to use some other audit method, or that the method selected was unreasonable or was unreasonably flawed in application (*see Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Shukry v. Tax Appeals Tribunal*, 184 AD2d 874, 585 NYS2d 531). Petitioner's claim that the auditor did not verbally ask petitioner for records, and never requested "source" documents from petitioner, fails to acknowledge the audit appointment letter and attached checklist each of which clearly requests and identifies specific documents,

including source documents, for audit. So too, this claim together with the claim that the auditor did not obtain a power of attorney relative to petitioner's accountant, Mr. Smith, overlooks the undisputed fact that the auditor was specifically directed to Mr. Smith by petitioner in order to obtain and review records.⁴ Overriding all of these arguments is the ultimate fact that no sales invoices, cash register tapes, or other original records of sales were ever maintained or produced by petitioner. As to purchase records allegedly pertaining to petitioner's only supplier, the totals thereof are significantly less than the cost of goods sold as reported on petitioner's Schedule C for two of the three comparable periods. Comparison of the records ultimately submitted by petitioner (specifically the Federal income tax returns at Schedule C and the purchase invoices) to the sales receipts reported on petitioner's sales tax returns and to the results of the audit not only supports the audit result but points to a conclusion that petitioner was significantly underreporting his sales and his sales tax liability. In sum, petitioner has not established that the audit method was unreasonable under the circumstances, that the results of the audit were unreasonably flawed or incorrect, or that his sales and sales tax liability were correctly reported.

G. Finally, petitioner challenges the imposition of penalties. On this score, it is clear that no records of sales were maintained or available for audit. Other records ultimately available, including purchase invoices, bank statements and tax returns, were not submitted for audit. The record does not disclose or describe the method by which petitioner or his accountant calculated, recorded or accounted for sales as reported on petitioner's sales tax returns or on Schedule C of

⁴ By brief, petitioner claims that Mr. Smith would not have been allowed to testify at hearing without a power of attorney. In fact, Mr. Smith would not have been allowed to appear as petitioner's *representative* at hearing without a power of attorney. The lack of a power of attorney, however, in no way prevented Mr. Smith from appearing at the hearing or providing testimony as a *witness* there. In fact, Mr. Smith was not present at the hearing, nor was he called as a witness by petitioner's representative.

his Federal income tax returns. In fact, there are substantial discrepancies not only between sales per sales tax returns versus sales as determined on audit, but also as between receipts per Federal income tax returns versus sales per sales tax returns. Finally, it is not insignificant that petitioner's sales tax returns showed a significant increase in reported sales in the quarterly periods immediately following receipt of the audit appointment letter. In view of these factors, imposition of penalties was appropriate and the same are sustained.⁵

H. The petitions of Joseph LoGiudice d/b/a Nino's Pizzeria of Patchogue and of Guiseppe LoGiudice are hereby denied and the notices of determination dated October 13, 1998 and November 5, 1998 are sustained.

DATED: Troy, New York
February 1, 2001

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

⁵ Further consideration of petitioner's claim regarding the gourmet pizza menu is revealing not only in the context of the results of the audit, but specifically with respect to the issue of penalties. Petitioner's claim is that the gourmet pizza menu, allegedly first introduced on the day of the observation, had specialty pizza prices approximately twice as high as those for pizzas on the regular menu, and that this factor resulted in far higher than normal sales receipts on the day of observation. In fact, assuming that the availability of doubly expensive gourmet pizzas on the observation day resulted in double the usual amount of sales during the (preceding) audit months, might lead to an argument that observation day sales (\$807.53) should be reduced by half to \$403.77. Following the remaining audit calculations (*see*, Finding of Fact "6"), such reduced total (\$403.77) would be further reduced by average reported taxable sales per day (\$98.40), resulting in audited unreported taxable sales per day of \$305.37. However, not only is there no documentation of actual sales receipts during the audit period to support such a claim for reduction of the observation day sales receipts but, moreover, comparing such reduced total (\$305.37) to average reported taxable sales per day (\$98.40) nonetheless still results in a substantial error (underreporting) rate of 310.33 percent.